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Aid for Trade: A Misdirected Initiative?

Arne Wiig

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Arne Wiig

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Contents

> "For poor developing countries it is not a case of aid or trade, nor of more aid or more trade, it is a case of more effective aid and a better composition of trade. Aid can support the costs of economic structuring and trade facilitation to improve the composition of trade. Trade can then promote growth".
> (Morrissey, 2006, page 86)

1. Introduction and background

Since the Doha Ministerial Declaration in 2001, the total commitment for Aid for Trade (AfT) has increased tremendously.[2] G-7 countries have pledged to double AfT by 2010. Multilateral donors have also scaled up their activities. These include the Integrated Framework for Trade Related Assistance (IF), the IMF's Trade Integration Mechanism (TIM) and the World Bank.[3] The scaling up has been linked to the Doha outcome, but the delivery of AfT is generally presumed to be the responsibility of aid and finance ministries and international agencies – not the WTO. During 2002-05, every second USD committed to AfT went to Asia (support to infrastructure constituted the main part), while Africa received 30% (OECD, 2007a). There were no Sub-Saharan African countries among the top 10 receivers of AfT. Tanzania was in this period the largest receiver within SADC but still it received a seventh of the amount directed to Vietnam.

Although there is some evidence that trade, growth and poverty reduction are correlated in SADC countries, trade has so far not played the catalytic role in Sub-Saharan countries that it has in East Asian countries. The Asian experience was based on the use of a deliberate industrial policy combined with an increasing opening up of international markets and trade. A main challenge for SADC is to enable member countries to reap the benefits from liberalisation by removing trading costs, facilitating infrastructural development, improving institutions and reducing tariff and non-tariff barriers. Complementary reforms are necessary in order to reap the gains from trade and aid for trade (AfT) might play an important catalytic role in facilitating these complementary reforms.

There is a convergence between the trade and development agendas (Suwa-Eisenmann, 2007). Rather than being a substitute for trade, the new convergence idea is that aid can be used as a complement to trade. There are different institutions and motivations behind the trade and development agendas, and aid and trade has consequently been geared towards a different group of countries. However, the discrepancies between the key motivations for providing aid and increasing trade might impede the effectiveness of AfT. Whereas the key motivation for providing aid is poverty reduction, this plays only a minor role in the trade agenda. Poverty can be seen as a public bad, and a reduction of world poverty requires financial support. Poverty reduction is also a key ingredient of what we normally characterise as development. In light of this, I argue that the legitimacy of AfT depends on whether increasing trade leads either directly or indirectly to poverty reduction.
In the Suwa-Eisenmann review (2007) of the relationship between aid and trade, it is, however, remarkable that the poverty issue is not discussed at all. In a review of current AfT programmes, the OECD reports that few donors have a link to poverty in their AfT programmes (OECD, 2007b).

Two vital conditions need to be in place in order to put countries on the trade route to development. First of all, trade should generate *pro-poor economic growth* in the long run and welfare gains for the poor in the short run through its impact on the prices and wages of what the poor produce (and

[2] 22% from 2002 to 2005, 11 % in 2006 and a further 8% in 2007. Based on CRS figures.
[3] The World Bank has completed an overview and assessment of its aid for trade activities http://www.globalpolicy.org/socecon/bwi-wto/wbank/2006/06tradeevaluation.pdf.

the prices of their consumption goods). The second condition for a successful trade route to development is that there be a *potential to increase trade* constrained by market failures. I argue that there is such a potential partly because of high prevailing trading costs within SADC while at the same time most SADC countries have market access to developed countries.[4]

This paper is structured according to the two criteria of success referred to above. In the following section, I discuss conditions in which trade reduces poverty. If trade takes place in sectors where the poor are numerous or it has a large impact on the income of the poor, it will naturally be more likely to have an impact on poverty. In the subsequent section, I discuss market failure motivations for providing AfT, such as coordination failures. Such failures might impede infrastructural development and increase the costs of logistics (trading costs). Through an analysis of AfT flows and their motivation, section 4 analyses whether AfT can generate pro-poor growth in SADC. The analysis highlights the motivations of poverty reduction and reducing trading costs. This section provides new data on global aid for trade during 2006 and 2007 and detailed data on the disbursement of AfT to SADC countries. The key question addressed is whether AfT is effective in the sense that those countries most in need of AfT do get higher support than other countries. The final section concludes.

[4] Tøndel and Wiig (2007) provide a more comprehensive analysis of the potential for increasing trade in SADC.

2. What type of trade can lead to poverty reduction?

Trade influences poverty indirectly through economic growth and directly through prices and wages. First, we explore the growth channel and then we proceed to analyse the impacts on prices and wages in the short run.[5] The types of sector that expand and income distribution in the country play an important role in how trade reduces poverty through economic growth. Generally, if more trade leads to higher agricultural production, rising wages for the unskilled and/or increasing employment, the poor are likely to gain from this process. These are two different but complementary approaches to analysing the poverty impact of trade reform.

2.1 Trade, inequality and economic growth

Trade and liberalisation of trade, both unilateral and multilateral, are thought to influence poverty through their *effect on economic growth in the long run* and on *wages and prices* (and therefore household welfare) in the short run.

Economic growth can be achieved through the accumulation of physical and human capital and technological change. *Institutions, international trade and geography* are referred to as the deeper determinants of growth that drives physical and human capital accumulation and technological change. Without the accumulation of capital or technological change, trade is unlikely to influence economic growth.

Openness promotes competition in domestic markets. Competition increases the pressure on firms to be innovative and provides consumers with a wider choice, ideally at lower prices. To exploit their comparative advantage, firms need to bring in new skills and technologies. Integration eases the transfer of technology between firms. Trade expands the market for domestic firms and thereby the return on infrastructural investments characterised by high fixed costs (roads, telephones, ports and so forth).

It is, however, hard to map out the exact relationships between trade and growth due to the interdependencies of all these variables and the income level. Both good institutions and higher trade volumes are associated with growth and higher income levels. *A major challenge in the literature is to disentangle the impact of trade on growth from that of institutions* (see Tøndel and Wiig, 2007).

Even though trade is found to increase growth, the impact on poverty is not a one to one relationship, as growth may increase *inequality*. The structure of the growth and its initial distribution are important for poverty reduction. Ravallion and Chen (2004) and Ravallion (2006) show that growth in agriculture in China had a four times higher poverty impact than growth in the secondary sectors. The higher the initial inequality in a country, the less the gains from growth tend to reach the poor (Ravillion, 2001). Among the growing economies the median decline in poverty (US$1 a day) is 10% in countries where inequality also declined, and only 1% for countries where growth was accompanied by rising inequality. Ravallion (2004) also finds that a 1% increase in mean income results, on average, in a fall of 2.5% in the proportion of people in absolute poverty (the poverty elasticity is equal to -2.5). Inequality increases about half the time (between countries) and there are gainers and losers at all income intervals within countries. Individual country experience varies around the average growth elasticity of poverty, and the poverty elasticity ranges

[5] See Winters et al. (2004) for a general review of the literature and Tøndel and Wiig (2007) for a review based on the SADC experience. Dollar and Kraay (2002; 2004) perform cross country analysis of the relationship between trade and poverty.

from -4.3 to -0.6 depending on how the growth process performs. Anderson et al. (2006) claim that Sub-Saharan Africa (SSA) has an even higher poverty elasticity (that means trade-induced growth will have a larger impact on poverty reduction in SSA) than in many other countries, partly because agriculture plays such an important role in SSA. Removing the strict assumptions applied in Anderson's analysis (full employment), Polanski (2006) finds that trade liberalisation has a significantly lower impact on poverty in SSA.

2.1.1 Empirical evidence from SADC on the trade-growth-poverty nexus: positive but small, partly due to increasing inequality

Within SADC the overall empirical evidence fits the picture of more trade being associated with lower levels of poverty. Lesotho, Malawi, Mozambique and Swaziland experienced both increasing trade and a reduction in poverty during 1990-2001. Zimbabwe and Zambia experienced an increase in the poverty rate and a decrease in trade over the same period. So the evidence from these countries also supports the notion that more trade is positively associated with poverty reduction while less trade is associated with higher levels of poverty. Madagascar, South Africa and Botswana show diverging experiences in trade and poverty. Both poverty and trade have decreased for Botswana and Tanzania while for South Africa and Madagascar the increase in trade has not been associated with poverty reduction (see Tøndel and Wiig (2007) for an overview).

When we consider the trade-inequality relationship, there is a tendency for increasing trade to be associated with rising inequality – a factor that offsets some of the gains in poverty reduction via trade-induced growth. The risk of increasing inequality is a factor that should be recognised by governments and donor communities when designing a policy for increasing trade.

2.2 Trade, prices and household welfare

In addition to its impact on economic growth, trade can also have more *direct impacts* on poverty through its effect on the *wages* of the unskilled in developing countries. It might also lower (raise) the *prices of consumption goods* and raise (lower) the *prices of goods produced* by the poor. Trade affects the prices that the poor face both as producers and as consumers. If the (consumption) prices of the goods they consume fall and the (production) prices of the goods they produce increase, trade will have a positive effect on poverty. If increasing trade leads to both increasing (decreasing) consumer and producer prices, the total effect depends on the net budget share of the consumed and produced goods. As SADC countries are net exporters of agricultural products, they will accordingly gain from an increase in the price of agricultural products (for instance, the removal of subsidies on cotton and sugar in developed countries), a general price increase of agricultural commodities or from a reduction in the domestic taxation of agriculture. Whether the poor will gain depends on their net position (whether their production is higher than their consumption of the good) and the potential impact on wages.[6]

It is also well documented that the earnings-side impacts dominate the consumption-side effects of trade reform. The importance of factor market effects is due to the fact that households tend to be much more specialised with regard to income sources than they are with regard to consumption. Income normally comes from a few sources while the consumption pattern is more diversified. It is also easier to switch consumption patterns than production patterns.

According to factor endowment theories of international trade, liberalisation will be pro-poor both in the short run and in the long run. In the short run, poverty will be reduced because the wages of

[6] All SADC countries from which we have data are net exporters of agricultural raw materials and food (WDI, 2008). This includes Madagascar, Malawi, Mauritius, South Africa, Tanzania, Zambia and Zimbabwe.

unskilled labour will tend to increase. This happens because countries will tend to export commodities that use abundant (and therefore relatively cheap) production factors intensively in the production process. This will drive up the demand for and therefore the price of the abundant factor. In the long run, when both capital and labour are mobile across sectors, this effect will be reinforced by the reallocation of capital into labour-intensive sectors. When a higher share of the capital stock is used in the labour-intensive sectors, the scarcity of labour will increase even more, and so will the wages of unskilled labour. These results are modified if input markets are inflexible.

If unskilled labour, machinery or farm technology is less mobile and is 'attached' to a specific sector (or crop), a reduction in protection for that sector will lead to a fall in income for workers (farmers) who are not able to relocate. However, an increase in the export activity of a sector would be beneficial to the workers (farmers) attached to that sector.

In order to reap the gain from a trade reform, the poor must be able to move out of the contracting sectors and into the expanding ones. The way the labour market is organised is vital for the impact of trade reform on poverty (see for instance Harrison, 2006).

2.2.1 Empirical evidence on the trade-price-welfare nexus: Complementary policies needed

Entrepreneurs involved in international trade are generally richer than those who are not (Bigsten and Soderbom, 2005; Wiig and Seleka, 2008), but it is unclear whether they are richer due to trade or because being rich plays an important role in whether you are trading or not. Being rich provides capabilities for trading. The impact of increasing trade on poverty might therefore reflect a self-selection of traders rather than that trade by itself leads households out of poverty.

Normally, poor entrepreneurs do not have enough assets to participate in international trade. Participating in international trade requires a number of assets that the poor lack, such as human capital, networks, or social capital, information and credit. There is thus an entry cost of trade that might impede the poor from participating in international or domestic trade transactions. If, for instance, local markets are not well developed, a farmer faces a risk when switching from subsistence farming to cash crop production. This risk restrains him from adjusting to new market opportunities. Similarly, the removal of trade barriers has a limited impact on trade patterns and poverty when there is unemployment as the effect of trade on unskilled wages is lower than when there is full employment (Polanski, 2006).

A low impact of trade on poverty can also partly be explained by an inefficient transmission mechanism. If a change in border prices does not transmit to the producer due to large domestic transport costs or other obstacles to doing business, the producer will not gain from potential trading opportunities.

The transmission mechanism diminishes with distance from the border and is lower in rural areas than in urban areas. That means people living in urban areas may notice the impact of liberalisation while in rural areas business is as usual.

Many studies find that a trade reform works best if complementary reforms are introduced simultaneously (see for instance Balat and Porto, 2006). These policies would include extension services, infrastructure, irrigation, access to credit, and education and health services. Arndt (2006) finds that in Mozambique, one third of rural households will be unaffected by Doha as international price changes will not transmit into changes in domestic prices. He concludes by underlining that

complementary reforms are needed in order to transmit price changes to rural areas and improve supply constraints.

The overall conclusion of this section is that increasing trade does not automatically translate into poverty reduction. The impact of trade on poverty increases when:

- Trade occurs in sectors where the poor are intensively involved (e.g. agriculture)
- Income distribution is not too skewed
- The labour market is flexible
- The transmission mechanisms are working well (trade costs are low)
- Producers respond to the potential market opportunities

3. Motivation and measures of AfT

After a discussion of market failure motivations for providing AfT, we give a brief overview and assessment of current policy measures regarding AfT.

3.1 Theoretical motivations for AfT

In a non-distorted economy, the potential for exports is highest in sectors with comparative advantages. If the firms know the cost structures and there are no market failures (e.g., public goods, externalities and information asymmetries) or government failures (e.g., macroeconomic instability, distorting government regulations or taxes, or corruption), there may be no reason for the government or donor agencies to get involved. If there are market failures or government failures, the focus should be on removing these failures.

3.1.1 Gains from liberalisation are a public good - Compensation

To achieve the potential gains from global liberalisation, there is a need for tariff reduction. Participation in WTO negotiations, the implementation of WTO rules (for instance, rules on veterinary standards) and the reduction of MFN tariff rates have some of the characteristics of a *public good* (Stiglitz and Charlton, 2006)**.** Trade policy reform has positive external effects that are not appropriately internalised by member countries, for instance on technology, human skills and the quality of institutions in a country and on other countries. Thus, benefits from liberalisation are not sufficiently internalised by individual countries, leading to underinvestment in trade reform. AfT increases the incentives for developing countries to participate in and enhance the world trading system. AfT might also enhance the possibilities of achieving Free Trade Areas within (and across) regional groupings.

The policy consequence of the public good perspective is an increase in AfT. The world's (or the regional) welfare gain from liberalisation provides room for increasing aid and aid should be used for i) integrating developing countries into the WTO and regional organisations, and ii) compensating those who lose from liberalisation at the multilateral or regional level. The first principle is acknowledged in AfT and is covered under the umbrella *aid to trade development*, while regarding the second principle there is so far no common agreement. Countries are as yet not being compensated for their loss from liberalisation.

From a public good perspective, those countries bearing the costs but achieving only minor gains should be compensated. As has been pointed out both in empirical studies and in predictions of Doha effects, trade liberalisation has *adjustment costs*. Adjustment costs are related to preference erosion, tax erosion and the loss of jobs in some parts of the economy. For SADC countries, at least for those which are net exporters of agricultural production, it is less likely that they will lose from multilateral liberalisation (see Tøndel and Wiig, 2007; Wiig and Seleka, 2008). However, a loss of tax revenue from international trade might be particularly harmful for some SADC countries where tariffs constitute a significant and reliable source of government revenue. It takes a long time to develop an ordinary taxation system (based on taxing firms' profits and households' income). Also, SADC countries with preferences will lose their preference margins and trade-related aid may compensate for this.[7]

[7] Trade preferences were originally given as an aid mechanism (trade as aid), while the argument has now been turned on its head (aid for lost trade). See Hoekman and Prowse (2005).

3.1.2 Government and market failures

In addition to the (international) public good argument, another motivation for AfT is that of *government and market failures.* Market access is a necessary but not a sufficient condition for export growth. Government and market failures make it difficult to reap the benefits of freer trade. Investment in potential new export products requires a 'good' investment climate characterised by a flexible labour market, a competitive product market, a low tax burden, non-arbitrary regulations and licensing procedures, and a lack of corruption. The absence of these qualities is frequently pointed to as instances of government failure, restricting investment opportunities. Foreign aid agencies lack the power to counter these government failures apart from underlining the *important role that good governance* plays for business activities. The situation is different for market failures such as *information asymmetries* in export markets and external effects (spillover impacts or increasing returns to scale in production). But also here donor agencies might lack the leverage to exert influence on these failures.

The successful development of East Asian countries indicates that what is exported may have a *spillover impact* on overall economic growth and that in order to produce goods with spillover impacts, government targeting and infrastructural investment play an important role. That said, spillover impacts do not arise only from exports and these spillover impacts are in many cases related to specific activities across sectors (learning spillovers). Promoting knowledge, learning and technology transfers is important for facilitating these spillovers. One technological spillover is related to infrastructure, which here is analysed as a coordination failure.

There are also *information externalities* in exports and production in general. For new products, technological success partly depends on the number of other investors making similar investments. The Desh company of Bangladesh was the first exporter of clothing from Bangladesh and paid the burden of entry into a new market. Based on its experience, other clothing companies were established in Bangladesh that were able to penetrate new markets at lower cost. Without any entrepreneur taking the risk of producing new products, a country will not move up the quality ladder. Early entrants may therefore provide valuable information spillovers for the rest of the economy. This externality provides a rationale for government (or foreign aid) support in order to produce new goods that may improve productivity. Within SADC, Lesotho and Mauritius have probably played a similar role in initiating the production of clothing products for export to the American market. The promotion of technology transfer, adoption of technology and support for standardisation are some relevant AfT elements that reduce these asymmetries.

The other point is related to *coordination failures* induced by scale economies. The competitiveness of domestic industries can often be promoted through large investments in infrastructure and the like. Poor roads, port facilities and telecommunications are among the factors that impede exports from developing countries. To overcome these barriers, large investments are needed. While profitable for the country as a whole, these investments will normally not be profitable for any single investor. Hence, coordinated action is needed. When these barriers occur at a regional level, no single country has incentives to provide the good and regionally coordinated action is the appropriate solution. Coordinated efforts to improve infrastructure are important in addressing the cost side of export procedures. So far, donors have paid little attention to regional public goods.[8]

In SADC there are a number of landlocked countries and these countries face high trading costs (see Table 3 below). Landlocked countries depend not only on their own performance, but also on the infrastructural quality and customs operations of the transit country. Harmonisation of procedures

[8] According to Arce (2002)), much of the focus in the public goods literature has been either on the national or the global level, not on the regional level. So far, there is a lack of data providing information about disbursement of AfT by SADC as a regional institution – we only have data on disbursement by member countries.

and documentation requirements would therefore be of even greater benefit to landlocked SADC countries. This can be achieved through harmonisation across countries, simplification of documents and setting up agencies to assist firms preparing products for export. A regional institution such as SADC can play an important role in addressing the trading costs of landlocked countries.

3.2 Policy measures of AfT

Comparing AfT with other aid initiatives, more emphasis is put on private sector development and a reduction in market failure, while traditionally aid has been targeted on the public sector or directly towards the poor. However, also here there is a 'convergence' which is evident from the categorisation of AfT described below.

There are three main categories of AfT (see Figure 1 for and overview and appendix 1 for a specification of sectors). The first is *trade policy and regulation* (this includes support to trade policy and administrative management, trade facilitation, support to regional or multilateral trade agreements, trade-related adjustment and training support). Trade policy and regulation constituted only 3% of total aid for trade commitments in 2007. The second and largest category is economic *infrastructural support* (to transport, communications and energy). Infrastructural support constituted 54 % of total aid for trade commitments in 2007. The third category is *building productive capacity*, which includes sectoral support to business support services, banking, agriculture, forestry, fishing, mineral resources and tourism. Building productive capacity constituted 43% of total aid for trade in 2007.[9]

At the total level, the composition of commitments of aid for trade was relative stable during the period 2002-2007, but for Africa the share committed to infrastructure increased from 51% in the period 2002-05 to 62% in 2007.

[9] There is also a category of adjustment costs, which is not included in this article. OECD is in the process of collecting data on this, but it is controversial whether this item should be included within AfT and which measure one should apply.

Figure 1: Key categories of aid for trade

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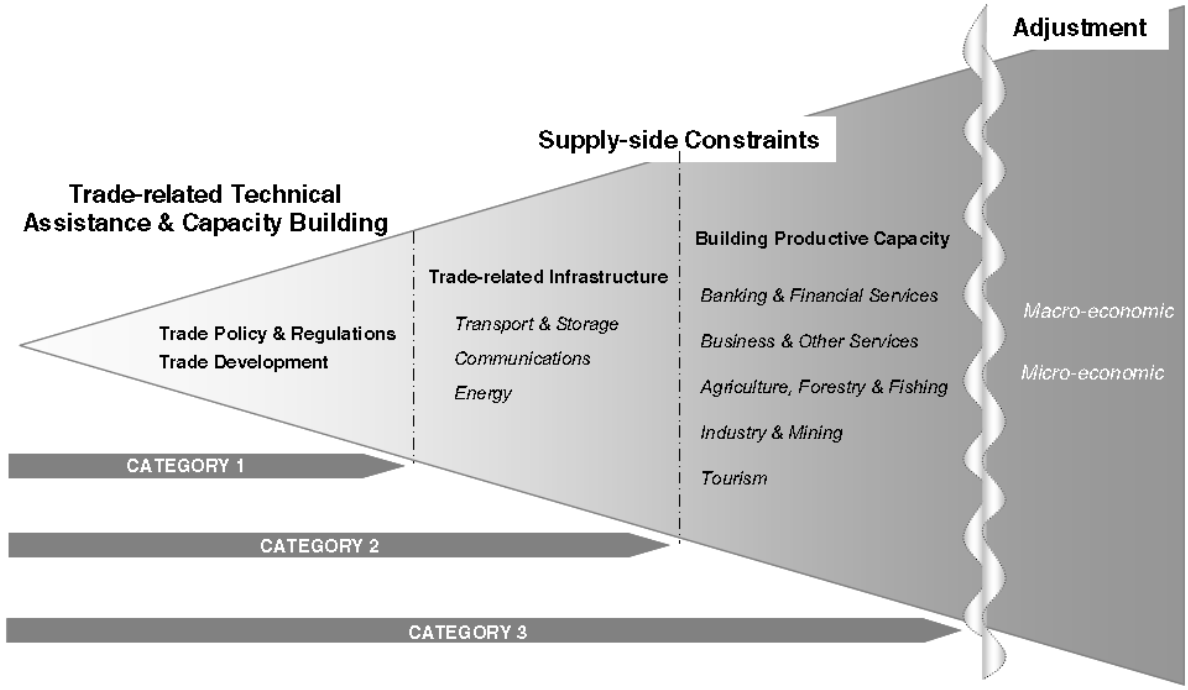

Source: OECD, 2006

AfT measures are blurred and not directly linked to the motivations discussed in the previous section. Including infrastructural support under the umbrella of AfT, the borders between AfT and other aid mechanisms have diminished but have not been completely eliminated. There is no clear consensus about what distinguishes AfT from other aid measures that promote the private sector. For instance, AfT includes all infrastructural investments in transport, communication and energy even if they do not have any direct impact on trade. Investments in transport are, for instance, termed AfT independently of whether the infrastructure is used for marketing the goods abroad or not. The same confusion applies to sectoral support. All support to sectors such as banking, business, agriculture, industry and tourism are termed productive capacity building even if the support is not directly linked to trade. What about compensation for adjustment costs related to trade liberalisation? Should it be characterised as AfT? Above, I argued that it should, but there is no consensus on this and so far these figures have not been included in OECD's estimates of AfT. OECD is in the process of using 'budget support' as a proxy for adjustment costs. If so, AfT measures will be ratcheted up. In most cases, such budget support has no close link with trade. Numerous other problems also arise with drawing clear lines between AfT and other aid initiatives. There are unclear boundaries between different aid categories and their motivations and it is accordingly difficult to assess both the effectiveness and the efficiency of the different AfT initiatives.

The blurred categories of AfT policy measures are not directly linked to the motivation for AfT. Hence, there is a risk of further de-emphasising the focus on poverty reduction as the key motivation for providing aid. No reference is made to poverty reduction in current measures of AfT. It is also noticeable from figure 1 that current initiatives (at least supply-side capacity building policies) focus on sectors (five sectors) rather than market failure. These policy measures do not directly relate to the market or government failure arguments discussed above. Externalities can, for instance, occur across sectors, which makes a sectoral approach less efficient. Targeting a specific

sector requires that the policy maker is able to identify a country's comparative advantage. Such identification is difficult, particularly if existing trading patterns are distorted due to government interventions such as trade restrictions or because of other market failures.[10] In the following section we will explore in more detail the relationship between AfT to SADC and its motivation.

[10] On the other hand, a sectoral approach makes it easier to support sectors in which the poor are located. But since the selection of a sector is not based on where the poor are located but on whether it is a 'productive' sector, the sectoral approach will only randomly target the poor (agriculture is an exception).

4. Can AfT generate pro-poor trade in SADC?

Low-income countries within SADC already have market access to the EU through the Everything but Arms Initiative (EBA), while the African Growth and Opportunity Act (AGOA) provides preferences in the US. So market access to developed countries is probably not the key problem – at least not for those SADC countries that fall within the group of LDCs that are favourably treated in preferential arrangements. Although market access to developed countries and various sanitary standards represent obstacles to increasing SADC trade, there are internal measures – not only tariff barriers but also other trading costs – that impede trade. While tariffs are discussed in Tøndel and Wiig (2007), a comprehensive review of trading costs is given by Tøndel (2008).

Tøndel (2008) finds that Sub-Saharan African countries, including SADC and landlocked countries in particular, comprise the most costly region to export from measured in both money and time. The cost of trade increases as the quality of physical infrastructure, human capital and institutions deteriorates, while exports as a percentage of GDP are higher when the time needed to export is lower. Thus, exports increase as the time needed for exporting decreases. There are accordingly internal trade barriers in addition to domestic tariffs, such as transportation costs, business obstacles to trade (inadequate infrastructure, lack of credit) and a low quality labour force, that serve as binding constraints on increasing trade. Without addressing these obstacles and trading costs, removing tariff barriers will probably have a minor impact on trade patterns as the transmission mechanism is not changed (see Tøndel and Wiig, 2007; Tøndel, 2008). On the other hand, the prevailing existence of obstacles indicates that there might be room for increasing trade through a reduction in trading costs and AfT measures can play a role in enabling this to occur.

Even if the cost of transport is relatively high in SADC, however, reducing the time needed to prepare documents and harmonise procedures might matter relatively more in terms of improving export performance. For agricultural products and products that are produced within a global supply chain network (clothing for instance), time matters for their exports.

There has been a shift over the last decade such that fresh and processed fruit and vegetables, fish, meat, nuts and spices account for more than 50% of total agri-food exports from developing countries. Traditional commodities such as coffee, tea, cocoa, sugar, cotton and tobacco have declined in terms of export share. This implies that proper facilities for storage and packing are of increasing importance, as is the time aspect of exporting. If countries wish to meet the growing demand for these products and thus reap their share of revenues, trade facilitation measures have to be addressed (Tøndel, 2008). Measures to improve the sanitary standards of agricultural products are also important for increasing agricultural exports (Wiig and Kolstad, 2005).

Timely delivery is also important for manufactured goods. A rising share of world trade is so-called 'vertical' specialisation, i.e. specialisation in the production of intermediate products.[11] When the production of final goods can be fragmented into several stages of production, we should find that some stages are capital-intensive but others are labour-intensive. A reduction in tariff barriers and technological innovation (lower costs of communication, information and transportation) encourage multinational companies to locate capital-intensive stages of production at home but labour-intensive stages of production in low-wage countries. A product (say clothing) can be broken up into separate intermediate products (or tasks) whereby each task (say design and assembly) can be

[11] Vertical specialisation occurs when i) goods are produced in multiple, sequential stages; ii) two or more countries provide value added in the production process; and iii) at least one country uses imported inputs in its stage of production process and some of the resulting output is exported (confer Hummels et. al. 2001).

produced across multiple firms, countries and times. Each firm participating in the supply chain specialises in tasks in which they produce most efficiently, and information technology is the glue that holds the different parts of the supply chain together.

In this new global economy there are additional gains from specialisation as firms take advantage of differences in the cost of labour and skills across countries to allocate tasks in time and space. Vertical specialisation and global outsourcing of intermediate products represent a growing export opportunity for developing countries, including SADC countries, but taking part in this trade requires the liberalisation of services and infrastructural development. Penetrating existing global supply chains based on vertical specialisation requires, for instance, timely delivery of high quality products. A concerted effort by SADC in many sectors at the same time may be necessary in order to participate in global outsourcing systems (Wiig et al., 2007).

There is an obvious poverty impact to be gained by reducing trading costs and improving the transmission mechanism of agricultural products within SADC (the poor are mainly in agriculture in SADC), as elaborated in Wiig and Seleka (2008), and concerted efforts should be taken to achieve this. There is not a similar obvious impact to be gained by removing trading costs within manufacturing unless such trade generates increasing employment of the poor, thereby raising the wages of unskilled labour, or unless a reduction in trading costs in manufacturing does not prevent other sectors from reaping the benefits (it is a non-excludable good). If the reduction of trading costs is not a public good but restricted to particular sectors, from a poverty perspective the focus should be on the sectors where the poor are numerous.

From a donor perspective, support to the agricultural sector, improvement of sanitary standards in agriculture and measures that ease the transmission mechanism in agriculture should accordingly be more important than manufacturing support or the improvement of standards in sectors where the poor are hardly involved.

4.1 AfT to SADC

Against the background of the key categories of AfT policies and the validity of the applied measures discussed above, we will in this subsection provide a descriptive overview of the development of AfT to SADC countries.

Total *commitments* of aid for trade constituted on average USD 21 billion per year during the period 2002-2005 or 34 % of total sector-allocated ODA (OECD 2007a:9). Total commitments increased by 11 per cent in 2006 and 8 per cent in 2007.[12] Asia is still the region with the highest commitment (42 %) while 37% of total aid for trade was committed to Africa (up from 30% during 2002-2005. Africa is the region that has experienced the highest increase in AfT commitments (a 23 % increase in 2007). Commitments to least developing countries increased by 30 % in 2007. SADC countries have not experienced a similar increase in commitments (by only 1.1 % in 2006 and 5.1 % in 2007).).

A recent global overview of AfT *commitment* to individual countries and group of countries is given by ECA (2009). A weakness with this study is that it does not cover actual disbursement – neither does it include more recent data for 2007 and updated AfT data for 2006. Disbursement figures are the (only) relevant to apply for statistical analysis, particularly when disbursement figures generally

[12] Commitment figures for 2002-2005 are based on OEDC (2007b). Later figures for commitments and all disbursement figures presented in this report are compiled on the basis of unpublished data provided by OECD. Total disbursement figures of aid for trade for all receiving countries are yet not available, although we have compiled figures for individual SADC countries.

are low while at the same time varies across countries. Table 1 below provides information about aid for trade to individual SADC countries sorted by *disbursement* in 2007.

In 2007 Madagascar was the SADC country that received the largest amount of AfT (approximately 170 million USD or 26 % of AfT to SADC). Mozambique was the second largest recipient of AfT (after being the most important one during the period 2002-2006). In addition to these countries, AfT plays or has played a significant role during recent years for Zambia, South Africa and Tanzania. In terms of AfT per capita, Namibia was the highest recipient of aid for trade in 2007 (see Table 3).

4.1.1 A descriptive overview

Table 1. Total aid for trade. Commitments, disbursement. ODA: USD thousands, 2006 Constant prices

	Commitments			Disbursements	
Country	2002-05 Average	2006	2007	2006	2007
Madagascar	255673	123945	147629	116143	170687
Mozambique	284230	316883	365965	198177	145691
Tanzania	103291	38718	135822	51612	64018
Zambia	178814	251898	160809	109276	53225
DRC	108545	141235	140463	50685	50778
Malawi	90793	107633	76450	37134	47260
South Africa	115331	115921	102904	80616	46345
Namibia	29377	103538	26482	19591	19413
Zimbabwe	9356	4417	29149	6495	14558
Mauritius	55406	38749	12615	1653	11310
Botswana	14163	1874	8661	9746	11267
Angola	17527	29984	90806	8549	10090
Lesotho	13983	18020	62099	4066	1061
Seychelles	2820	3548	650	5788	566
Swaziland	3074	295	2356	1701	-878
Total SADC	**1282382**	**1296660**	**1362861**	**701233**	**645391**

Source: Compiled based on data from OECD.

There has been a decline (-8 %) in the disbursement of AfT within SADC from 2006 to 2007. The disbursement ratio is also extremely low and declining. Total disbursement for all SADC countries in 2007 as a share of commitments for the same year was only 47 %, and this figure would be significantly lower if we excluded Madagascar, which received high AfT and had a high disbursement rate.

Currently, the AfT aid channel only plays a minor role for SADC countries. From Table 2, specifying the aid for trade flows within SADC, the disbursement of AfT constituted 14 % (USD 645 million) of total sector-allocable ODA to SADC countries in 2007. The distribution of disbursement of AfT mirrors the worldwide total commitments of AfT in 2007 referred to above. About 55 % (USD 353 million) is used for productive capacity building in SADC and 41 % for infrastructure, which is similar to worldwide figures. Commitments to infrastructure constituted 61 % of AfT in 2007 for SADC (as compared to 54% worldwide), but infrastructure constituted only

41 % of disbursement. SADC experienced a low disbursement ratio of infrastructure, particularly in transport and storage.

Table 2. Aid for trade flows. SADC

Aid-for-Trade Flows: CRS Proxies						
					ODA: USD thousands, 2006 constant pric	
Country:	**SADC countries**	**Commitments**			**Disbursements**	
CRS purpose codes		**2002-05 average**	**2006**	**2007**	**2006**	**2007**
TRADE POLICY AND REGULATIONS and TRADE-RELATED ADJUSTMENT						
33110	Trade Policy and administrative management	7 080	13 988	11 034	10 161	9 929
33120	Trade facilitation	1 582	1 977	1 673	2 649	2 219
33130	Regional trade agreements (RTAs)	254	2 046	2 633	2 123	2 143
33140	Multilateral trade negotiations	226	0	0	274	0
33150	**TRADE-RELATED ADJUSTMENT**	0	0	508	0	13 135
33181	Trade education/training	972	273	159	287	308
	sub-total	**10 115**	**18 284**	**16 006**	**15 494**	**27 735**
ECONOMIC INFRASTRUCTURE						
21010 to 21081	Transport and storage	488 944	403 754	690 225	278 083	193 247
22010 to 22040	Communications	33 432	33 389	19 530	30 958	14 145
23010 to 23082	Energy supply and generation	140 511	99 103	127 047	62 035	57 269
	sub-total	**662 887**	**536 245**	**836 802**	**371 075**	**264 661**
BUILDING PRODUCTIVE CAPACITY					*(Includes Trade Development activitie*	
25010	Business and other services	121433	14242	49953	63962	42431
24010 to 24081	Banking and financial services	104918	44897	85700	23829	10042
31110 to 31195	Agriculture	206103	420357	280580	166387	230777
31210 to 31291	Forestry	18809	4329	9397	6178	11426
31310 to 31391	Fishing	34557	23646	14964	24979	17429
32110 to 32182	Industry	26804	158501	54460	14975	24080
32210 to 32268	Mineral resources and mining	90163	54844	7586	11679	9790
33210	Tourism	6594	21313	7413	2676	7021
	sub-total	609381	742130	510052	314663	352996
TOTAL AID-for-TRADE		**1 282 382**	**1 296 660**	**1 362 861**	**701 233**	**645 391**
TOTAL SECTOR ALLOCABLE ODA		**5 944 977**	**6 381 352**	**7 558 151**	**4 543 396**	**4 695 873**

***Source*: Compiled based on OECD, Creditor Reporting System.**

4.2 Motivation and effectiveness of AfT

Finally, we have explored whether the disbursement of AfT reflects some of the main objectives or 'needs' in SADC in terms of poverty and problems with trade logistics. In line with Alesina and Dollar (2000), I use aid per capita as our dependent variable and GDP per capita as a measure of poverty. In order to measure trade logistics, I apply a new index developed by the Bank on logistic performance (LPI).[13]

[13] The Logistics Performance Index is based on a survey of operators on the ground worldwide (global freight forwarders and express carriers), providing feedback on the logistics "friendliness" of the countries in which they operate and those with which they trade. Feedback from operators is supplemented by objective data on the performance of key components of the logistics chain in the home country.
http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTTRANSPORT/EXTTLF/0,,contentMDK:21514122~menuPK:3875957~pagePK:210058~piPK:210062~theSitePK:515434,00.html

The LPI measures performance along the logistics supply chain within a country and LPI is the simple average of the country scores (on a scale from 1 to 5 where 5 reflects that the country scores high on logistical quality) in seven key dimensions:

- Efficiency and effectiveness of the clearance process by customs and other border control agencies;
- Quality of transport and IT infrastructure for logistics;
- Ease and affordability of arranging shipments;
- Competence in the local logistics industry (e.g., transport operators, customs brokers);
- Ability to track and trace shipments;
- Domestic logistics costs (e.g., local transportation, terminal handling, warehousing); and
- Timeliness of shipments in reaching destination

Tanzania is the SADC country that scores lowest on the LPI while South Africa scores highest (best).

Table 3. Aid for trade. Needs as measured by trading costs, logistic performance index and poverty

		Costs to exports US$ per container	Logistic performance index	GDP/ capita (2007)	Aft per capita	Disbursement Policy and Reg 2007 (1)	Disbursement Infrastructure 2007(2)
Angola		1850	2,48	1069	0,6	918	2476
Botswana	*L*	2328	.	4423	6,1	69	59
Congo, DR	*L*	2307	.	90	0,8	12	29033
Lesotho	*L*	1188	2,30	527	0,5	164	436
Madagascar		1182	2,24	237	8,9	157	91983
Malawi	*L*	1623	2,42	144	3,5	1074	8788
Mauritius		728	2,13	4522	9,0	144	59
Mozambique		1155	2,29	330	6,9	7046	80865
Namibia		1539	2,16	2166	9,5	117	3300
Seyshelles		1839	.	7004	6,7	0	0
South Africa		1087	3,53	3562	1,0	1605	4591
Swaziland	*L*	1798	.	1400	-0,8	0	-1369
Tanzania		1212	2,08	334	1,6	14602	37885
Zambia	*L*	2098	2,37	371	4,6	1713	6101
Zimbabwe	*L*	1879	2,29	428	1,1	113	454

Sources: The Doing Business Database; http://www.doingbusiness.org (2007 figures apart from Seyshelles where we only had 2008 figures)

http://info.worldbank.org/etools/tradesurvey/mode1a.asp?countryID=150

WDI 2008

OECD

L: landlocked

As we only have disbursement figures of AfT for two years and only for 15 SADC countries, it is premature to undertake a comprehensive statistical analysis. I have therefore purified the poverty motivation and the motivation to reduce the logistical problems SADC countries face by undertaking a simple regression analysis between the supply of AfT to individual SADC countries and the demand. Demand is measured by needs in term of poverty (Model 1) or logistical problems (Models 2a and 2b). The only difference between models 2a and 2b is the AfT measure applied. Both motivations are simultaneously analysed in Model 3. I have only controlled for whether the country is landlocked (Model 4), as are many SADC countries, which may therefore face different logistical problems than their non-landlocked counterparts. One should be very cautious in drawing too strong conclusions based on so few observations and control variables.

Table 4: AfT disbursement and motivation. Results based on a simple regression analysis for SADC countries

Dependent: Total aid for trade disbursement per capita (2007)[14]	Model 1	Model 2a	Model 2b	Model 3	Model 4
GDP per capita	0.0006 (0.056)			0.001 (0.025)	0.008 (0.24)
LPI		-3.80 (0.2)	-0.001 (0.41)	-5.44 (0.001)	-5.18 (0.003)
Landlocked					-2.1 (0.41)
Constant	2.88 (0.024)	13.38 (0.08)	0.004 (0.24)	15.8 (0.001)	16.4 (0.005)
Explained variation	0.14	0.17	0.07	0.37	0.44
Observations	15	11	11	11	11

The correlation between AfT per capita and poverty is 0.37. In contrast to what we would have expected, lower income countries within SADC receive *less* AfT per capita than richer countries. The relationship is not strong (the regression coefficient is 0.0006). The relationship between poverty and AfT is significant in models 1 and 3 (significance levels are given in brackets).

We have also analysed whether the countries within SADC that face the largest problems with logistics do receive higher AfT or whether AfT is mainly tailored to the countries that have the best facilities for promoting trade. Those countries that face higher logistical problems (as measured with LPI) receive higher AfT per capita. The correlation coefficient is -0.41 in Model 2a. This is a good sign. However, this relationship is not significant. LPI is significant in Model 3, but this relationship stems from our applied measure of AfT. As trade policy and regulation and economic infrastructure are mainly tailored to deal with logistic problems, but sector support is not, we have analysed the correlation between LPI and these figures (the sum of the last two columns in Table

[14] In Model 2b we have used disbursement to policy and regulation and to infrastructure only.

3).[15] Again, we find that countries with higher logistical problems receive more AfT per capita (the correlation coefficient is -0.27), but LPI is not significant (see model 2b).

One might expect that there is a larger need for AfT to landlocked countries as they face high costs of exporting due to natural conditions. However, we do not find any evidence for this. There is a tendency for landlocked countries to receive less AfT, but the relationship is not significant in any of the models. Aft does not seem to cover the specific problems faced by landlocked countries.

With the limitations of the above analysis in mind, we can conclude that AfT is not effective (in reaching its target). The tendency is for richer SADC countries to receive higher AfT. Although it appears that those SADC countries that face higher logistical problems receive most, the relationship between logistical problems and AFT disappears when applying an appropriate measure of AfT (reflecting AfT that deals directly with logistics). The robustness of the initial positive finding that AfT is tailored to SADC countries which face the largest logistical problems is further weakened by applying an alternative World Bank measure of trading costs. When done, the correlation is turned on its head. Higher trading costs (as measured by costs to exports) generate less AfT.[16] The lack of robustness may reflect a lack of validity in our measures, but at the same time it is more likely that it reflects the lack of a clear relationship between the motivation for providing AfT and actual disbursement figures.

In the overview by OECD (2007b) of recent evaluations of Trade Related Assistance (trade policy and regulations and trade development, but not aid to infrastructure), some similar conclusions are drawn.

The main conclusion from this study is that there are two preconditions for success:

i) the existence of a favourable domestic business environment;
ii) political will to use trade as an engine for development.

Other factors, such as adequate governance, market access and international competitiveness, also greatly influence effectiveness and impact. Accordingly, AfT should be targeted on countries that are most able to utilise it – a factor that might shed some light on the low level of AfT to SADC countries.

The study emphasises that trade-related assistance programmes should be implemented after a review of initial internal (through a needs assessment) and external conditions in the potential country to support. Up to now, there has been a lack of such assessment and trade-related assistance has been fragmented, with insufficient synergies with broader development assistance programmes and weak linkages to poverty reduction – a conclusion that is supported in our study of SADC.

However, the study mentions Mozambique as one of the few developing countries committed to making openness to trade an integral part of its strategy for sustaining rapid economic growth and alleviating poverty. AfT has accordingly been instrumental in helping Mozambique mainstream trade and other trade-related measures effectively and include indicators in its medium-term poverty reduction strategy. AfT has also helped Mozambique to stimulate public and private dialogues and partnerships, addressing supply-side constraints and integrating it into the multilateral trading system.

[15] The final category of AfT is Support to productive capacity, and data for this category can be derived by subtracting the two last columns in Table 3 from total disbursement figures for 2007 in Table 1.

[16] To the extent that a large share of AfT is devoted to port facilities, it might reflect the situation that landlocked countries do not receive as much AfT as their trading costs reveal. Note that a country such as Mauritius scores low on LPI (high logistical problems) but generally scores high on business indicators such as 'Ease of doing business' and low on 'Trading across border' (see Tøndel 2008 for a discussion of trade costs in SADC).

Since before the slogan of AfT was coined, the International Trade Centre has been dealing with policies to help developing countries to increase trade, partly based on the perspective of overcoming market failures. Similarly, export promotion agencies in developing countries have been put in place for some of the same reasons. Experiences from these activities are mixed but give important insights into targeting exports from developing countries. Lederman et al. (2006) found that some characteristics are particularly important for export promotion agencies (EPA) in developing countries. They are more efficient when the export promotion activities are shared with other activities such as investment promotion and export financing. Their onshore export support services (exporter training, technical assistance, capacity building, including regulatory compliance, information on trade finance, logistics, customs, packaging, pricing) are more important than country image, marketing and market research activities. Finally, the presence of EPAs' offices in foreign markets does not appear to help exports from developing countries. They also find that for the median agency, $1 of export promotion creates $300 of exports. For every $1 in the EPA budget there is an additional $490 dollars of exports in Latin America, $227 in Asia and $137 in SSA. These figures are quite impressive and are supported by others. Rose (2005) found that for each additional consulate abroad, exports increased by 6 to 10 percent. There is, however, a lack of evidence that the poor reap any of these benefits, which represents a key challenge for future AfT activities.

5 Conclusion

There is no evidence that trade liberalisation – even if it is comprehensive trade reform – will alone be able to achieve the Millennium Development Goal of halving poverty rates. There are high trade costs in SADC that constrain reactions to price signals from trade liberalisation. Export responses are slow. At the same time, poverty is so widespread in most SADC countries that what can be achieved from trade liberalisation alone will be modest.

A reduction in trading costs and the time needed for exports in SADC is vital for promoting trade that also favours the poor. Improvement of infrastructure in sectors such as agriculture and a reduction in transport costs are important to increasing trade. Coordinated efforts among SADC countries should be made to undertake these investments. AfT measures should be applied explicitly to dealing with market imperfections with the main purpose of improving the welfare of the poor.

At the global level, there is currently a lack of focus on the motivation for AfT and how it can be measured. With this lack of focus, the risk arises that foreign aid may be unnecessarily spent on groups or tasks that do not need such support. Given the high population within SADC that is poor, it is therefore important that not only donors but also regional organisations like SADC tailor their aid programmes towards reaching the poor in their AfT programmes.

AfT can support complementary reforms in the SADC countries and thereby increase the impact of increasing trade on poverty reduction. While one of the weaknesses of past initiatives for promoting trade liberalisation is the lack of investment in complementary initiatives (see, for instance, the evaluation of past aid for trade initiatives by the World Bank (2006)), one problem with the argument for complementarities is finding the right mix of complementary investments (in telecommunications, roads, port facilities, energy, and also in human capital) and governance conditions that facilitates trade and exploits complementarities. These investments will vary across countries and sectors and require in-depth, case-specific competence, including competence on governance issues.

Believing that increasing trade by means of AfT is THE solution to poverty reduction is misplaced. When discussing the scale of a future AfT programme, the importance of other policies, such as safety nets for the poor, education and a pro-poor industrial policy, must not be forgotten. Increasing AfT will necessarily have alternative costs and there is a risk that AfT might reduce other more targeted poverty measures.

Like other types of foreign aid, without proper *needs assessment and implementing capacity* AfT may lead to an inefficient use of aid funds. We do not find that there is a close relationship between the disbursement of AfT and the needs the SADC countries face. There is also a large problem of low disbursement ratios within SADC countries that should be addressed.

Donor agencies and SADC should enhance the positive effects of their trade-related assistance by creating synergies with broader development assistance and poverty reduction programmes. Needs assessments can help identify the mitigating measures or complementary activities required to protect the poor. Furthermore, trade-related assistance could target sectors or activities in which poor people are strongly represented and remove market failures in trade.

The discrepancy between what AfT should do (fighting poverty and reducing imperfections in trading) and what it actually does indicates that there is a need for further research on the donors' motivations for providing AfT and what specific aid initiative is needed for that purpose. This needs more country-specific analysis.

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SUMMARY

Given that the motivation for aid is poverty reduction, I argue that Aid for Trade (AfT) measures need to demonstrate that they are effective and have a potential impact on poverty. The debate about aid for trade measures lacks a focus on the poverty dimension of trade. Trade is an indirect instrument for poverty reduction and in SADC, increasing trade has a low impact on poverty. From a donor perspective, support to sectors such as agriculture, where the poor are located, is therefore more effective than to sectors or activities in which the poor are hardly involved.

While the overall motivation for providing aid for trade is poverty reduction, I argue that such aid should only be given if there are market failures, for example in coordination and public goods. Aid for trade is particularly important for countries that already have market access but face supply constraints that restrict their utilisation of this market access (as is mainly the case for SADC countries). In this case, aid and trade might serve as complementary activities.

I present new data of AfT to SADC countries. The main finding is that so far AfT has played only a minor role for SADC countries, and its role has not changed significantly during recent years – at least not in terms of disbursement. The disbursement ratio of AfT is low (around 50 %). We do not find any robust relationship between disbursement of AfT among individual SADC countries and documented needs. There is accordingly scope for major improvement in the effectiveness of AfT.

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